Wayne
ALL 12/14/89

UTELITE SELF-BONDING QUALIFICATIONS
ADDITIONAL COMMENTS

1. The self-bonding qualifying factor for Net Worth = $10 million appears to be quite high for a $100,000 bond requirement. Net Worth is 100 times the bond amount.

2. The self-bonding qualifying factor for Fixed Assets = $20 million appears to be quite high for a $100,000 bond. It is not clear if gross or net assets should be used, i.e. is depreciation netted out. The standard should likely be fixed assets net of depreciation, since fixed assets are originally recorded at cost. Assets costing a million may have little value if you had to sell to collect on the bond, depending on the age of those assets. check w/ fam? net?
   a) Utelite's fixed assets net of depreciation are $603,208. As stated previously, we also don't know if any of their assets are pledged.

3. Non-conformance with GAAP does not appear to materially impact the financial statements in regards to the ratios desired. For example, the income tax basis impacts depletion expense which is not large, and handling of the involuntary conversion gain (actually GAAP requires recognizing the gain in '86 which would mean this $288,962 would be reflected in a larger stockholder equity).

4. The key issue remaining is that the CPA wasn't willing to issue an opinion since he only conducted a "review" which is substantially less in scope than an audit. Thus, the figures reflected on the statements must be trusted on their face. Only an audit could prove them.
   a) A bond is likely a cheaper alternative than a certified audit. Using rough numbers, 60 hours of a CPA's time at $80 an hour would result in a bill of $4800. Bonds premiums normally cost 1% to 2% of the face amount for those companies strong enough to obtain them, thus $1000 to $2000. Therefore, bonding is cheaper.

   b) An option would be for the oil and gas audit staff to conduct a verification of some of the major accounts recorded by Utelite. Of the three staff members, two have degrees in accounting and one is in finance. All have experience in accounting and auditing of varied industries, however none specific to this product. None are CPA's though. While the salary costs to perform this type of verification would be approximately one-fifth of a CPA, I wonder if it is appropriate for the State to spend such resources to qualify an operator for self-bonding when a bond could be obtained for the same expense. Essentially the operator has then shifted this expense from his account to the State's. Also, since we don't perform this type of financial audit everyday like CPA's do, the number of hours expended by our staff would likely be greater than the CPA.

c) Allowing self-bonding is equivalent to co-signing a loan. If the operator doesn't hold up to his agreement, we must be willing to expend the money ourselves. Would we personally co-sign a loan with a person who brought his financial statements to us which had not been verified? Likely not. There is significant risk taken even if the statements are certified by a CPA.

HOI18/1

Wayne Hedberg

Whereas,the operator h submitted a December 31, I988 co orate financial statemental statement 988 income tax basis) in accoror ce with standards established by the American Institute of Certified Public Accountants and these financial data include assets and liabilities information which establishes the baseline financial standing of the Operator for future determinations of financial capability to perform reclamation under this Agreement.

Barbara:

If we substitute this language for existing paragraph 4, P2 Self Bonding and Indemnity Agreement (Utelite), does this solve our language problem? If so, the only other place to change language I've found is the Self Bond Qualification sheet.

please advise.

Lowell 12.6